



0000160153

BEFORE THE ARIZONA CORPORATION

Arizona Corporation Commission

COMMISSIONERS**DOCKETED**

JAN 22 2015

SUSAN BITTER SMITH – Chairman
 BOB STUMP
 BOB BURNS
 DOUG LITTLE
 TOM FORESE

DOCKETED BY

nr

IN THE MATTER OF THE APPLICATION OF
 UNS ELECTRIC, INC. FOR AN ACCOUNTING
 ORDER IN CONNECTION WITH THE
 ACQUISITION OF UP TO A 25% INTEREST IN
 GILA RIVER POWER PLANT UNIT #3.

DOCKET NO. E-04204A-13-0476

DECISION NO. **74911****OPINION AND ORDER**

DATE OF HEARING:

December 15, 2014

PLACE OF HEARING:

Tucson, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

APPEARANCES:

Michael Patten, ROSKA, DEWULF &
 PATTEN, PLC, and Bradley Carroll, UNS
 Electric, Inc., on behalf of UNS Electric, Inc.;

Daniel Pozefsky, Chief Counsel, Residential
 Utility Consumer Office;

Charles Hains and Matthew Laudone, Staff
 Attorneys, Arizona Corporation Commission
 Legal Division, on behalf of the Utilities
 Division.

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the
 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT**Procedural History**

1. On December 31, 2013, UNS Electric, Inc. ("UNSE" or "Company") filed an
 Application with the Commission seeking approval of an accounting order authorizing the deferral for
 future recovery of non-fuel costs associated with the Company's prospective purchase of up to a 25

1 percent interest in Unit 3 at the Gila River Power Plant.

2 2. On March 7, 2014, intervention was granted to Arizona Public Service Company
3 ("APS") and the Residential Utility Consumer Office ("RUCO").

4 3. On October 28, 2014, the Commission's Utilities Division ("Staff") filed the Direct
5 Testimony of Gerald Becker recommending approval of an accounting order subject to Staff's
6 proposed conditions and clarifications.

7 4. On October 29, 2014, RUCO filed a Request for Procedural Order seeking a procedural
8 schedule in this matter.

9 5. By Procedural Orders dated November 3, and November 6, 2014, a telephonic
10 Procedural Conference was set for November 17, 2014, to discuss establishing procedures for this
11 matter.

12 6. UNSE, RUCO and Staff appeared through counsel at the November 17, 2014
13 Procedural Conference, and agreed on a process for a hearing in this matter.

14 7. By Procedural Order dated November 18, 2014, the matter was set for hearing on
15 December 15, 2014, and other procedural deadlines established.

16 8. On December 2, 2014, UNSE filed affidavits of publication indicating that public
17 notice of the hearing was published on November 28, 2014, in the *Nogales International*, in Santa
18 Cruz County, Arizona, and on November 29, 2014, in the *Today's News-Herald* in Mohave County,
19 Arizona.

20 9. On December 5, 2014, RUCO filed the Direct Testimony of Jeffrey Michlik, and
21 UNSE filed the Direct Testimony of Dallas Dukes.

22 10. On December 12, 2014, UNSE filed the Plan of Administration ("POA") for the
23 proposed accounting order.

24 11. On December 15, 2014, the hearing convened as scheduled before a duly authorized
25 Administrative Law Judge at the Commission's offices in Tucson, Arizona. Mr. Dukes, the Senior
26 Director of Pricing and Economic Forecasting for Tucson Electric Power Company ("TEP") testified
27 for UNSE. Mr. Dukes is responsible for monitoring and determining revenue requirements, customer
28 pricing and rate structures for all the regulated subsidiaries of UNS Energy Corporation ("UNS

Energy”), including UNSE. Mr. Michlik, a Public Utilities Analyst V, testified for RUCO. Gerald Becker, Executive Consultant III, testified for Staff.

12. At the hearing, UNSE introduced a revised POA that included a minor addition from the version that was docketed on December 12, 2014.¹ A copy of the POA, as agreed to by UNSE, Staff and RUCO is attached hereto as Exhibit A.

Background

13. UNSE is a wholly owned subsidiary of UNS Energy, and provides electric service to approximately 93,000 customers in Mohave and Santa Cruz Counties.²

14. UNSE states that it filed the subject application in December 2013 because it has the opportunity to acquire up to a 25 percent interest in the Gila River Power Plant Unit 3 (Gila River Unit 3” or “Unit 3”), which is a combined-cycle natural gas fired power plant located on approximately 1,100 acres within the Gila Bend town-site, about 75 miles southwest of Phoenix and 30 miles south of the Palo Verde Trading hub. According to UNSE, Gila River Power Plant consists of four “power blocks” with each block representing 550 MW of nominal capacity. UNSE’s sister company, TEP, which provides electric service in Pima and Cochise Counties, will acquire the other 75 percent of Unit 3.

15. The Federal Energy Regulatory Commission (“FERC”) approved UNSE’s acquisition of the interest in Gila River Unit 3 from Gila River Power, L.L.C., and the Company closed the transaction in the second week of December 2014. UNSE does not need Commission approval to acquire an interest in Gila River Unit 3.

16. UNSE states that Gila River Unit 3 provides the Company with a unique opportunity to address its need for base load generation at a reasonable price.³ Prior to the purchase of Unit 3, UNSE states that it relied on the wholesale market for approximately 85 percent, or 300-325 MW, of its annual resource capacity needs, and that acquisition of the share in Unit 3 will reduce its market-based capacity exposure by 45 percent.⁴ UNSE states that although its heavy reliance on wholesale

¹ December 15, 2014 Hearing Transcript (“Tr.”) at 6 and 13.

² Application at 2.

³ Ex S-2 Dukes Dir at 1.

⁴ *Id.* at 2-3.

1 power has not been problematic in recent years when natural gas prices and capacity values have
2 remained low, for the long-term, market forces could drive energy and capacity costs up and reduce
3 the availability of low cost market resources. UNSE claims that the Commission acknowledged
4 UNSE's risk in May 2013 when it advised UNSE and other load serving entities about future short-
5 term market purchases in their long-term Integrated Resource Plans ("IRPs):

6 The cost and availability of such purchases are subject to a wide array of
7 influences that are difficult, if not impossible to predict. For example, if a
8 large number of older coal-fired generating plants are retired in the western
9 region, the availability of such purchases will decline dramatically, and the
 cost of such purchases will increase significantly. Reliance on short term
 market purchases in a long-term plan is difficult, if not impossible to
 justify.⁵

10 In UNSE's 2012 IRP and confirmed in its 2014 IRP, the Company stated that it will look for
11 economically attractive plant acquisition opportunities to firm up its long-term capacity needs.⁶

12 17. UNSE states that an advantage of the Gila River Power Plant is its proximity to
13 transmission and natural gas supplies.⁷ UNSE asserts that the Gila River Power Plant is one of the
14 most efficient combined-cycle plants in the Western Electric Coordinating Council ("WECC") region.
15 With a heat rate of approximately 7,000 British thermal units ("BTUs") per kilowatt-hour ("kWh"),
16 UNSE believes that it provides a solid base resource by reducing the overall heat-rate when compared
17 to market heat rates and existing assets.⁸

18 18. UNSE asserts that acquiring its share of Unit 3 is a significant investment for UNSE, as
19 the purchase price of approximately \$55 million represents about 28 percent of the Company's
20 original cost rate base established in its last rate case. In addition, the Company states that the non-fuel
21 operating costs associated with the purchase are expected to be approximately \$9 million by the end of
22 2015, and if not deferred and subject to potential future recovery, would reduce net income by 42%
23 (based on 2013 operating results).⁹

24 19. At the time of the hearing, UNSE's debt was rated Baa1 by Moody's Investor Service
25

26 ⁵ Application at 2 *quoting* Decision No. 73884 at 4.

27 ⁶ Application at 2 *citing* UNSE IRP at 13.

⁷ Ex A-2 Dukes Dir at 4.

⁸ *Id.*

28 ⁹ *Id.* at 5-6; Tr. at 14.

1 (“Moody’s”).¹⁰ UNSE argues that without an accounting order that would allow the deferral of certain
2 operating expenses associated with Unit 3, the Company would face financial burdens because of the
3 size of the investment relative to its capitalization. The Company is particularly concerned about
4 maintaining its credit rating as it expects to refinance \$80 million of its existing long-term debt due in
5 2015.¹¹

6 **UNSE’s Deferral Request**

7 20. Because UNSE’s share of the purchase price of Gila River Unit 3 is a substantial
8 investment relative to its current rate base, UNSE is seeking an order that would allow the deferral for
9 future recovery of the non-fuel costs of maintaining and operating the plant. Following discussions
10 with Staff, the Company revised its request from that originally set forth in its application. The
11 Company seeks authorization of the following:¹²

12 (a) The deferral of the non-fuel costs associated with owning, operating and
13 maintaining UNSE’s share of Unit 3 including Operating and Maintenance (“O&M”) expenses,
14 depreciation and amortization expense, property taxes and carrying costs at a rate of 5.0 percent
15 annually;

16 (b) Reductions to UNSE’s purchased energy and capacity costs to be retained by the
17 Company from the purchase date through the date on which on the plant is placed into rate base upon
18 completion of the Company’s next rate case;¹³

19 (c) During this period, the purchased energy and capacity savings would serve to off-
20 set all, or a portion of, the increase in the Company’s non-fuel costs associated with owning and
21 operating Unit 3;

22 (d) Upon completion of the Company’s next rate case, the ongoing energy and capacity
23 cost savings provided by Unit 3 would be passed onto customers, thus mitigating an expected future
24 increase in the Company’s non-fuel base rates;

25 (e) The purchased energy cost savings shall be calculated monthly based on the

26 ¹⁰ Ex A-2 Duke’s Dir at 6. This is an upgrade from Baa2 since the Company filed its Application.

27 ¹¹ Tr. at 20.

27 ¹² *Id.* at 6-8.

28 ¹³ Thus, the benefits of lower fuel or power costs that would otherwise flow to ratepayers through the Purchase Power and Fuel Adjustment Clause (“PPFAC”) will also be deferred.

1 difference between the actual Unit 3 fuel costs (net of revenues from short-term wholesale sales) and
 2 the market value of Unit 3 energy production used to service retail load (calculated using published on
 3 and off-peak market prices from the Intercontinental Exchange ("ICE"));

4 (f) The avoided cost of capacity purchases shall be \$1.52 per kW/month, which is
 5 based on third-party quotes for 2015 demand (capacity) options, and which is approximately \$2.5
 6 million on an annual basis;

7 (g) The margin from short-term wholesale sales shall be based on revenues from short-
 8 term wholesale sales less the actual fuel costs for Unit 3 allocated to wholesale sales;

9 (h) The reductions to UNSE's purchased energy and capacity costs, and the increases
 10 in the margin on short-term wholesale sales, resulting from the ownership of Unit 3, shall be
 11 calculated monthly; and

12 (i) The amount of these cost savings recovered through UNSE's PPFAC shall not be
 13 included in the Accumulated PPFAC Bank Balance for purposes of calculating accrued interest.

14 21. UNSE asserts that although its revised request is somewhat different from what it
 15 requested initially, the revised approach recognizes several benefits from the deferral of benefits
 16 including: (1) a better matching of customer savings with the costs associated with owning and
 17 operating Unit 3; (2) mitigation of the initial customer rate impact expected to result from UNSE's
 18 next rate case; and (3) improved cash flow for UNSE during the cost deferral period, which should
 19 further support the Company's investment grade rating.¹⁴

20 **Staff's Position**

21 22. Staff supports approval of an accounting order in this proceeding in conformance with
 22 the Company's revised request which matches deferred savings and deferred costs, and produces a
 23 less volatile rate impact.¹⁵

24 23. Staff agrees with the Company's revised request, and recommended that the deferral of
 25 costs be subject to both a time and dollar limitation. Staff recommends approval of an accounting
 26 order as follows:

27 _____
 28 ¹⁴ Ex A-2 Dukes Dir at 8; Tr. at 22, 25-27.

¹⁵ Ex S-1 Becker Dir. Executive Summary; Tr. at 65-66.

1 (a) That cost subject to deferral be limited to:

2 (i) Depreciation and amortization costs;

3 (ii) Property taxes,

4 (iii) O&M expenses, and

5 (iv) Carrying costs, calculated at 5.0 percent annually, associated with owning,
6 operating, and maintaining the plant;

7 (b) That certain benefits of owning the plant shall also be deferred;

8 (c) That the value of deferred benefits shall be subject to inclusion in the Company's
9 ongoing PPFAC calculations;

10 (d) That the deferred cost and deferred benefits shall be evaluated in a future rate
11 proceeding;

12 (e) That the ratepayers be held harmless for any deferred costs in excess of deferred
13 benefits;

14 (f) That the amount of any deferred benefits in excess of deferred costs shall be used as
15 a reduction to the running balance in the PPFAC arising from non-Gila River Unit 3 activity;¹⁶

16 (g) That any authorizations to defer costs shall be limited to \$10.5 million;

17 (h) That any authorizations to defer costs shall expire no later than May 1, 2016. Any
18 expense incurred after April 30, 2016, would not be eligible for deferral; and

19 (i) That no prudence determination be made at this time and that the prudence of the
20 purchase of Gila River Unit 3 will be determined in a future rate proceeding; that there shall be no
21 carrying costs on any under-recovered PPFAC balance resulting from the purchase of Gila River Unit
22 3; and that the Company file a plan of administration within 30 days of the filing of testimony for
23 consideration and inclusion in the final decision.

24 24. Staff disagrees with UNSE's interpretation of its IRP pursuant to Decision No. 73884.
25 Staff states that in Decision No. 73884, Staff concluded that UNSE should reduce its reliance on short-
26 term purchases to meet its long-term needs, and this could be achieved by pursuing long-term
27

28 ¹⁶ Tr. at 57.

1 purchased power and not just the purchase of the power plant as Staff believes the Company seems to
 2 suggest. Staff states that Decision No. 73884 did not order UNSE to buy a power plant, nor has UNSE
 3 sent any proposals to secure long-term power contracts as an alternative to purchasing Gila River Unit
 4 3.¹⁷

5 **RUCO's Position**

6 25. RUCO supports approval of an accounting order as recommended by Staff and the
 7 Company in this proceeding because:

8 (a) UNSE is only asking that 25 percent share of the Gila River Unit 3 be subject to
 9 deferral, and TEP is not requesting a deferral order for the other 75 percent interest;

10 (b) RUCO agrees with the Company that the acquisition of Gila Unit 3 will have a
 11 significant impact on UNSE's financial statements, and that if an accounting order is not approved,
 12 this could affect UNSE's financial viability in the future;

13 (c) The environmental risks are less for a combined cycle natural gas-fired unit than for
 14 a coal-fired unit, and the lower environmental risks will benefit both UNSE and its ratepayers;

15 (d) UNSE is not requesting deferral of decommissioning costs;

16 (e) It is expected that ratepayers will benefit through UNSE's PPFAC;

17 (f) The transaction will result in an acquisition discount, which benefits both UNSE
 18 and its ratepayers;

19 (g) There is a deferral time period and limitation on the amount that can be deferred;

20 (h) Ratepayers will be held harmless for any deferred costs in excess of deferred
 21 benefits, and there will be no carrying costs on any under-recovered PPFAC balance resulting from
 22 the purchase of Gila River Unit 3; and

23 (i) Although RUCO generally does not approve of carrying costs, RUCO believes that
 24 a carrying cost of 5.0 percent is reasonable in this case and this case only for the reasons cited above.¹⁸

25 26. RUCO agrees with Staff's recommendations and recommends an additional condition
 26 as follows: in the event a settlement agreement is reached in UNSE's next rate case, any changes to

27
 28 ¹⁷ Ex S-1 Staff Dir at 5.

¹⁸ Ex RUCO-1 Michlik Dir at 22-23 (emphasis in original); *see also* Tr. at 36-36 and 52-53.

1 the deferral order including changes to the carrying costs shall be thoroughly explained in the
2 settlement agreement.¹⁹

3 27. RUCO believes the proposed accounting order is in the best interest of ratepayers and
4 agrees with the final POA as presented at the hearing.²⁰

5 **Plan of Administration**

6 28. The POA, attached as Exhibit A, describes how the proposed Gila River Power Plant
7 Unit 3 Acquisition Deferred Accounting Order will operate. The POA allows UNSE to defer certain
8 defined non-fuel costs for the period January 1, 2015 through the earlier of April 30, 2016, or the date
9 new rates goes into effect.²¹ It provides that the cumulative non-fuel costs will not exceed the lower
10 of \$10.5 million or the cumulative deferred savings as of April 30, 2016. The deferred savings will
11 continue to accrue until new rates go into effect, but the deferred costs will not extend beyond April
12 30, 2016. The POA provides that UNSE will file monthly reports with Docket Control, and to RUCO
13 detailing the calculations related to allowable costs and savings.

14 29. The POA defines the costs and savings eligible for deferral consistent with the parties'
15 testimony, except that the POA does not include express recognition that decommissioning costs will
16 not be included in the eligible O&M costs.²²

17 30. The POA should be amended to reflect the agreement of the parties that
18 decommissioning costs related to Gila River Unit 3 are not included as part of eligible deferred costs.

19 **Analysis and Conclusion**

20 31. An accounting order is a rate-making mechanism that allows the deferral of costs
21 and/or savings by a regulated utility for possible future recovery or credit.

22 32. Under the typical ratemaking process, until the Commission would authorize the
23 inclusion of the Gila River Unit 3 in rate base, UNSE would not be able to recover the costs of
24 operating the plant in rates. By approving an accounting order and the POA, the Commission is

25
26 ¹⁹ RUCO's proposed recommendation was inspired by events occurring in a proceeding involving Arizona Public Service.

²⁰ Tr. at 32.

²¹ POA Section 1.

27 ²² RUCO's testimony explicitly mentions that decommissioning costs will not be included in the deferred costs. Ex
28 RUCO-1 at 16 and Tr. at 35. Mr. Dukes confirmed that the Company will not seek the deferral of decommissioning costs
which are usually included as part of depreciation expense. Tr. at 29.

1 authorizing UNSE to create a regulatory asset composed of the cumulative eligible deferred costs
2 related to operating Gila River Unit 3, and a regulatory liability consisting of the eligible deferred
3 savings. The Commission will determine how to amortize the regulatory asset and liability in UNSE's
4 next rate case which is expected to be filed in the second quarter of 2015. Absent such accounting
5 order, UNSE would be required by Generally Accepted Accounting Principles ("GAAP") to expense
6 the operating costs of the plant in the period incurred, and these costs could not retroactively be
7 recovered as part of rates.

8 33. We find that under the particular circumstances of this case, approving an accounting
9 order, governed by the provisions of the POA as modified herein, is in the public interest. UNSE has
10 shown, and Staff and RUCO agree, that the acquisition of the Gila River Unit 3 is likely to benefit the
11 Company and ratepayers by providing an efficient and economical source of baseline power, but that
12 the financial cost of acquiring and operating UNSE's share in Gila Unit 3 is substantial and may
13 detrimentally impact the Company's financial condition. The accounting order is intended as a bridge
14 to maintain UNSE's financial condition until its next rate case. As the parties have agreed, ratepayers
15 are protected by the limits in amount and in time of the eligible deferred costs, and by the provision
16 that deferred costs cannot exceed the deferred benefits.

17 34. By approving the POA, the Commission makes no findings concerning the prudence
18 of the purchase of the Gila River Power Plant Unit 3 for ratemaking purposes.

19 CONCLUSIONS OF LAW

20 1. UNSE is a public service corporation within the meaning of Article XV of the Arizona
21 Constitution and A.R.S. §§ 40-250, 40-251, 40-221, 40-361 and 40-367.

22 2. The Commission has jurisdiction over UNSE and the subject matter of the application.

23 3. Notice of the application was provided in accordance with the law.

24 4. It is reasonable and in the public interest to authorize UNSE to defer, for possible later
25 recovery through rates, the non-fuel costs (as defined in the Plan of Administration) of owning,
26 operating, and maintaining its share of the Gila River Power Plant Unit 3.

27 5. The cost deferral authorized herein does not constitute a finding or determination that
28 the deferred costs are reasonable, appropriate, or prudent.

6. This Decision should not be construed to limit this Commission's authority to review the accumulated deferred balance associated with all amounts deferred pursuant to this Decision and to make disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

ORDER

IT IS THEREFORE ORDERED that UNS Electric, Inc. is authorized to defer for possible later recovery through rates, the non-fuel costs (as defined in the Plan of Administration as modified herein) of owning, operating and maintaining its approximate 25 percent share in the acquired Gila River Power Plant Unit 3.

IT IS FURTHER ORDERED that the Plan of Administration attached hereto as Exhibit A is approved as modified to reflect the parties' agreement that decommissioning costs related to the Gila River Power Plant Unit 3 will not be included in the eligible deferred O&M costs.

IT IS FURTHER ORDERED that nothing in this Decision shall be construed in any way to limit this Commission's authority to review the entirety of the acquisition and to make any disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

IT IS FURTHER ORDERED that UNS Electric, Inc., shall within 10 business days of the effective date of this Order, file with Docket Control as a compliance item in this docket, a revised Plan of Administration that reflects the modification approved herein as well as the information related to this Decision No. and date in Section 1 of the Plan.

IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare and retain accounting records sufficient to permit detailed review, in a rate proceeding, all deferred costs and deferred savings as authorized herein, and shall comply with the monthly reporting requirements as set forth in the Plan of Administration.

• • •


• • •

• • •

IT IS FURTHER ORDERED that in the event a settlement agreement is reached in UNS Electric, Inc.'s next rate case, any changes to the deferral order, including but not limited to the carrying costs, shall be thoroughly explained in the settlement agreement.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

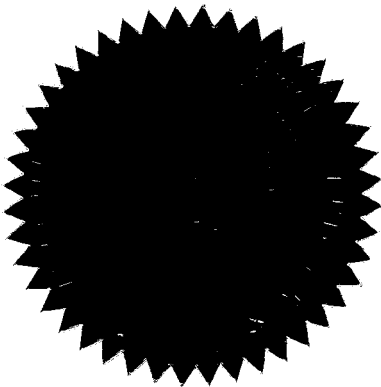

CHAIRMAN


COMMISSIONER


COMMISSIONER


COMMISSIONER


COMMISSIONER



IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 21st day of January 2015.


JODI JERICH
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____
JR:tv/ru

1 SERVICE LIST FOR: UNS ELECTRIC, INC.

2 DOCKET NO.: E-04204A-13-0476

3 Bradley Carroll
4 Kimberly A. Ruht
5 UNS Electric, Inc.
6 88 E. Broadway Blvd
7 MS HQE910
8 PO Box 711
9 Tucson, AZ 85702

7 Michael W. Patten
8 Jason D. Gellman
9 Roshka DeWulf & Patten, PLC
10 One Arizona Center
11 400 East Van Buren Street, Suite 800
12 Phoenix, AZ 85004
13 Attorneys for UNS Electric, Inc.

11 Daniel W. Pozefsky
12 Chief Counsel
13 Residential Utility Consumer Office
14 1110 West Washington, Suite 220
15 Phoenix, AZ 85007

14 Thomas L. Mumaw
15 Melissa Krueger
16 Pinnacle West Capital Corporation
17 P.O. Box 53999, MS 8695
18 Phoenix, AZ 85072-3393

17 Meghan H. Grabel
18 Arizona Public Service Company
19 P.O. Box 53999, MS 9708
20 Phoenix, AZ 85072-3999

20 Janice Alward, Chief Counsel
21 Legal Division
22 ARIZONA CORPORATION COMMISSION
23 1200 West Washington Street
24 Phoenix, Arizona 85007

23 Steven Olea, Director
24 Utilities Division
25 ARIZONA CORPORATION COMMISSION
26 1200 West Washington Street
27 Phoenix, Arizona 85007